

M e m o r a n d u m

To: Chairman Douglas
Vice Chairman Boyd
Commissioner Byron
Commissioner Eggert

Date: July 16, 2010

From : **California Energy Commission** -- Claudia Chandler, Chief Deputy Director
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Subject: Proposed action items on the July 28 and August 6 Business Meetings and guidance on Property Assessed Clean Energy programs

The staff of the Energy Commission is noticing two action items for consideration and approval by the Energy Commission at the following two Business Meetings.

1. At the July 28 Business Meeting staff is requesting the cancelation of both the Program Opportunity Notice (PON) 400-09-401 for Municipal Financing Programs funded by the American Recovery and Reinvestment Act of 2009 (ARRA) through the State Energy Program (SEP), and the Notice of Proposed Awards issued there under.
2. At the August 6 Business Meeting staff will be proposing amendments to the State Energy Program Guidelines (Guidelines).

These two related actions are prompted by recent developments that cast serious concerns over the viability of first-priority liens as near term municipal financing options for residential energy efficiency and renewable energy retrofit projects. First-priority liens are central to Property Assessed Clean Energy (PACE) programs and required in municipal financing programs authorized by AB 811 (Levine, Chapter 159, Statutes of 2008). First-priority liens were also an essential element of the solicitation for municipal financing programs described in PON 400-09-401.

PACE programs are strongly supported and encouraged by federal, state and local decision-makers. The U.S. Department of Energy (DOE) encouraged State recipients of ARRA SEP funding to invest in sustainable programs utilizing PACE financing to promote energy efficiency retrofits in residential, commercial and municipal buildings.

In Fall 2009, when the Federal Housing Financing Agency (FHFA) signaled its concern with assessments that might displace primary mortgage holders, the federal government responded with a strong policy statement and program criteria to address those concerns. (Attachment A, Policy Framework for PACE Financing Programs and Attachment B. Guidelines for Pilot PACE Financing Programs.)

Nevertheless, in May and June 2010 the FHFA continued to formally broadcast its opposition to PACE programs (Attachments C & D, Letters from Freddie Mac and Fannie Mae). Conversations with federal officials the week of June 28, 2010 forecast the strong likelihood of an upcoming formal announcement regarding PACE financing. On July 6, 2010, the FHFA issued a statement concluding that the PACE assessments constitute a first-priority "loan" which is contrary to the Fannie Mae-Freddie Mac Uniform Security

Instrument. (Attachment E, FHFA Statement on Certain Energy Retrofit Loan Programs.) The Office of the Comptroller of the Currency (OCC) at the same time issued a bulletin raising “significant safety and soundness concerns” over PACE programs in the commercial and residential sector. (Attachment F, OCC Bulletin 2010-25.)

In response to this guidance from the federal financing regulators, DOE issued the following statement:

“The DOE and Administration continue to support pilot PACE financing programs. Recovery Act grantees are not expressly prohibited from using funds to support viable PACE financing programs, however the practical reality is that residential PACE financing programs with a senior lien priority face substantial implementation challenges in the current regulatory environment. In light of the clear opposition from the regulators for PACE financing programs with a senior lien priority, *prudent management of the Recovery Act compels DOE and Recovery Act grantees to consider alternatives to programs in which the PACE assessment is given a senior lien priority.*” (Attachment G, Status Update – Pilot PACE Financing Programs [emphasis added].)

Despite the FHFA and OCC pronouncements, PACE programs continue to be championed throughout California. State leaders are vigorously advocating to revive PACE as an important tool to help promote energy efficiency, reduce fossil fuel dependence, stimulate the economy and create jobs. The California Attorney General, with full support by the Governor, filed a lawsuit against the FHFA for a declaratory judgment that PACE financing involves assessments and not loans, and to enjoin adverse action against any mortgagee who is participating in a PACE financing program. (Attachment H, Brown vs. FHFA, U.S. District Court, N.D. Cal., C10-03084 filed July 14, 2010, and Attachment I, Governor’s Press Release dated July 14, 2010.)

To ensure that residential energy efficiency and renewable energy investments are not underutilized and are allowed to reach their maximum potential in the state, the California Public Utilities Commission and the Energy Commission both asked for assistance from the California Congressional Delegation. The CPUC’s letter appealed to the California Congressional Delegation for leadership to reverse the effect of the FHFA and OCC determinations. (Attachment J, CPUC Letter dated July 13, 2010.) Chairman Douglas’ letter respectfully requested the California Congressional Delegation’s assistance and leadership to ensure that federal energy policy is not undermined and that the State can continue to move forward efficiently with ARRA funding to create jobs, increase renewable energy generation, reduce energy use and greenhouse gas emissions. (Attachment K, Energy Commission letter dated July 16, 2010).

The immediate resolution of the PACE financing issue is of such grave importance to California, that fourteen members of the California State Legislature sent a letter to the California Congressional Delegation asserting that FHFA’s

“new policy position places a serious cloud over the many California homes and businesses that have already encumbered their properties with PACE assessments and dramatically reduces, if not eliminates, the pool of homeowners and businesses that would consider participating in PACE programs going forward. Despite strong support for PACE from a bipartisan majority of the California Legislature and from the Obama administration, FHFA’s recent actions essentially halt one of California’s best tools for weatherizing buildings, installing solar panels, retrofitting homes and businesses for major water savings - and creating jobs. Up to a billion dollars in retrofit projects are at stake. Absent immediate legislative action by Congress or other appropriate federal relief, California’s launch of the largest retrofit program in the country cannot move forward, and the efforts California has made working in harmony with our counterparts at the federal and local levels to launch this popular job creation/energy saving program will not move forward.” (Attachment L, California Assembly Legislature letter dated July 14, 2010).

Staff requests that the Energy Commission act quickly and definitively to expand the financing options available to California municipalities for energy efficiency and renewable energy residential retrofit projects

thereby ensuring that the Energy Commission has viable financing programs to encumber ARRA funds prior to the DOE ARRA SEP deadline. This approach is consistent with DOE's position that in light of the regulatory uncertainty, we must consider alternatives to PACE programs. If there was not an urgent deadline to encumber the ARRA funds, we may be able to await the outcomes of legislative advocacy and litigation, in hopes of preserving the results of the solicitation. The Chair of the Governor's Recovery Task Force has expressly called on the Energy Commission to redirect the funds no later than September 30, 2010. (Attachment M, Letter from Richard Rice dated July 15, 2010.) The ARRA SEP federal grant requires the Energy Commission to fully obligate the funds by October 21, 2010.

The primary priorities of the ARRA SEP funding are to stimulate the economy, create jobs, reduce energy use and greenhouse gas emissions, and generate renewable energy. To achieve these important priorities, we must put the money to work now. Time is of the essence in redirecting these funds into programs that can accomplish these priorities immediately.

Therefore, the two actions for your consideration are: 1) to cancel the Municipal Financing Program solicitation and the Notice of Proposed Awards under PON 400-09-401 allowing the redirection of the funds; and, 2) to amend the Guidelines at the August 6th Business Meeting to give the Energy Commission flexibility to redirect the funds and expand the programs to include financing options in addition to first-priority liens. The Guidelines amendments are drafted to enable the funding of PACE programs should the legislative advocacy and litigation be successful, and also permit the inclusion of other financing options, including but not limited to subordinate liens and unsecured lines of credit. The amendments also will provide more flexibility to direct the funding through other available programs and mechanisms, including the Energy Conservation Assistance Account (ECAA) loan program, and the Clean Energy Business Financing Program, among other things.

In conclusion, these two actions are presented as the most prudent way to meet our ARRA SEP grant deadlines in light of the FHFA and OCC opposition to PACE programs, while retaining as much flexibility as possible for the Energy Commission to take advantage of strategic opportunities to advance energy efficiency in California. This memorandum will be supplemented by a more detailed staff report that will be submitted as additional backup material for this agenda item.